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Ms. Marcia Madsen
Chair
Acquisition Advisory Panel
c/o General Services Administration
1800 F Street, N.W. Room 4006
Washington, DC 20405

Dear Madam Chair:

On behalf of the Army and Air Force Exchange Service (AAFES), I would like to thank the Panel for this opportunity to present information about AAFES to you. I hope that this will be both informative and helpful to you.

Although AAFES is part of the federal government, I have found that we are somewhat of a mystery to many people. First I will give you some background on AAFES operations worldwide. Next I will briefly talk about the statutes and regulations on which AAFES procurement is based. These will include two statutes that permit appropriated fund federal agencies to purchase goods and services from military exchanges such as AAFES. The majority of this presentation will focus on AAFES in relation to the three areas of interest to the Panel – interagency purchasing, commercial practices and performance-based contracting.

I will conclude by mentioning three areas of concern that impact federal commercial procurement, specifically on the government's ability to purchase goods and services as efficiently as private industry. It is our belief that changes in the processes and procedures related to these areas will improve the efficiency and effectiveness of procurement throughout the federal government, both in the appropriated and nonappropriated arenas. These areas include the Service Contract Act (SCA), the Prompt Payment Act (PPA), and limitations on assessing penalties against government contractors.

One of AAFES' mottos is "Serving Those Who Serve." AAFES, along with military exchanges operated by the Navy, the Marine Corps and the Coast Guard, exist to support the military community.

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AAFES goes where are customers go. We serve our customers wherever they are – even in remote locations and war zones. AAFES operations in these areas are staffed by a dedicated cadre of AAFES civilians and deployed military members assigned to AAFES.

AAFES has been in business, in some form, for more than 100 years. We have two missions - to provide reasonably priced good and services to our customers, and to contribute our profits to military morale, welfare and recreation funds, also known as "MWR." Last year AAFES generated \$8 billion in revenues and contributed \$226 million to MWR funds. This money pays for quality of life facilities on military installations worldwide, such as child care centers, libraries, and gymnasiums.

Since the AAFES profit, or dividend as we call it, is distributed after AAFES overhead and other costs are paid for, any savings that AAFES can achieve through efficiencies and economies ultimately benefits AAFES customers and the military community as a whole. Use of nonappropriated funds (NAF) to pay for these quality of life facilities saves the taxpayers money. And there is an argument to be made that being able to provide a better quality of life for our servicemembers and their families aids in military recruitment and retention, creating a stronger military and a safer country. How does that relate to procurement? I would argue that more efficient procurement practices save money, which is ultimately passed to the customer in the form of better prices on goods and services, and increased dividends. AAFES therefore has a stake in the debate concerning procurement laws and regulations that Congress intends primarily for appropriated fund agencies but that also applies to nonappropriated fund instrumentalities (NAFIs).

AAFES gets almost all of its revenues from sales to customers. In fact, ninety-eight (98) percent of AAFES' budget is NAF that come from these sales. These funds are not appropriated by Congress and are used to pay for AAFES' operating costs. Things that AAFES pays for include construction of facilities, cost of goods sold, overhead, administrative expenses, and the salaries of AAFES employees. AAFES employees are federal government employees by law, but they are not civil service employees.

The remainder of AAFES' budget, or only two (2) percent, comes in the form of appropriated dollars. These funds are not appropriated directly to AAFES but instead come indirectly in the form of salaries paid to military members assigned to AAFES, or money given to AAFES by the Army to offset the cost of shipping goods overseas.

At the heart of AAFES is the "company store." Our Army customers call these stores Post Exchanges (PXs), while our Air Force customers call them Base Exchanges (BXs). These stores carry an assortment of retail merchandise just like a department store, but at discount prices. In addition to these main stores, AAFES operates shoppettes, which are smaller convenience stores; gas stations; car care centers; book stores, and movie theaters. AAFES is one of the largest Burger King franchisees and operates other brand name fast food outlets such as Taco Bell and Kentucky Fried

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Chicken. AAFES has also developed in-house food brands such as Anthony's Pizza and Robin Hood sandwiches.

AAFES manages the military uniform program for the Army and Air Force, to include operation of Military Clothing Sales Stores. Overseas AAFES operates ice cream and bread plants, so that our customers can purchase fresh, American-style food while stationed in foreign countries. AAFES runs a paper catalog and internet site allowing customers to order by mail or online. AAFES manages the Military Star credit card program, which is a private label credit card available to all eligible exchange customers.

If AAFES cannot provide a service to customers directly, we often provide it through concession contracts. Concessionaires are independent contractors licensed to operate in AAFES facilities for a fee paid to AAFES. Typical concession contracts at a military installation include laundry and dry cleaning; florist shops; beauty and barber shop, optical shops, and both brand name and "mom and pop" operations selling everything from gifts to vitamins.

Eligibility to use a military exchange is determined by Congress, not the exchanges themselves. AAFES has 11.5 million eligible customers. Although "Army" and "Air Force" are in our name, any U.S. military member from any service can shop at AAFES. The majority of AAFES customers are retired military members and their families. The other main categories of customers are active duty military members, Reservists and National Guard members, and their families. AAFES also serves Department of Defense (DoD) civilian employees in overseas locations.

Obviously the AAFES customer demographic is extremely diverse. Because we purchase most of the goods and services that we sell, to have an effective retail program AAFES must employ contracting officers with specialized expertise in retail goods and consumer services. This retail expertise generally does not exist within the government.

At the same time, AAFES purchases the supplies, services and equipment needed to run our operations, such as office supplies, computer programming services, and equipment ranging from copy machines to forklifts. We also build and renovate our own facilities and finance some operations with commercial loans. Getting the best value during these diverse types of procurement demands a diversified workforce of highly-trained contracting officers.

In 2004 AAFES spent \$7 billion on procurement overall, while AAFES concessionaires generated \$1.2 million in sales. The AAFES worldwide workforce numbers more than 45,000 employees. The majority of AAFES procurement is done by 216 employees in the Dallas, Texas headquarters.

Essentially, procurement within AAFES can be broken down into two main categories: procurement for resale, and internal procurement. Within existing legal and regulatory

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constraints, AAFES has developed different philosophies and policies for these two categories of procurement. I will discuss these in a few minutes - but first I would like to give you a brief overview of the statutory, regulatory and other guidance that applies to AAFES procurement.

From a technical legal standpoint, AAFES is a "nonappropriated fund instrumentality" or NAFI. This is a term coined by the Supreme Court in 1946. Simply put, "nonappropriated" means not appropriated by Congress. "Fund" means money. "Instrumentality" is a synonym for "entity" or "activity." Put that all together and the meaning is clear - a NAFI operates without appropriated funds from Congress. Although I noted earlier that AAFES does receive some appropriations, these are indirectly provided to AAFES and are restricted to certain purposes. For example, the reason AAFES receives funds for overseas transportation is to mitigate against higher overseas shipping costs. This enables AAFES to keep prices overseas the same as those in the United States, thus avoiding an additional cost to customers simply because they are stationed in an area where transportation costs are more expensive. This limited amount of appropriated funding does not change the legal character of AAFES as a NAFI.

I should note that AAFES is not a federal agency or a government corporation. Within the AAFES legal world, and consistent with Supreme Court precedent, we take statutes and regulations very literally. If a statute or regulation does not mention the military exchanges, AAFES, NAFIs or federal instrumentalities, we take the position that it does not apply to AAFES. That doesn't mean that DoD or AAFES can't adopt principles from nonapplicable statutes or regulations. For example, as I will address in a minute, most federal procurement statutes and regulations do not apply to NAFI procurement. Despite that, I think you will see AAFES procurement policies and procedures mirror the spirit and intent of the Federal Acquisition Regulation (FAR). The differences between AAFES procurement and appropriated fund procurement can be found in the interpretation and execution of those principles.

AAFES was created by regulation, not statute. Although there are statutes that can and do apply to AAFES operations, there is no single statute that brought AAFES into existence. The modern version of AAFES was created by regulations issued by DoD after World War II.

As you know, many federal laws have a direct impact on the ability of the federal government to have complete flexibility when procuring goods or services with taxpayer's dollars. Most of these laws do not apply to federal NAFIs or to the military exchanges.

There are two laws applicable to the military exchanges that, if used as intended, may in fact increase the flexibility of federal government procurement. Both are intended to expand the ability of federal agencies to purchase goods and services from the military exchanges. However, as you will see, neither law gives federal agencies the

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unlimited right to purchase all goods and services they need from the military exchanges.

One law is 10 United States Code 2492. It permits an agency or instrumentality of DoD that supports a military exchange or MWR activity, to enter into a contract or other agreement with any federal agency, department or instrumentality. For example, it permits AAFES – an instrumentality of DoD that supports a military exchange – to enter into a contract with the State Department. The contract or agreement must be for goods or services beneficial to the efficient management and operation of the exchange or MWR system.

From AAFES' standpoint, the key word in this law is "agreement." When the government does business with itself – for example, when two agencies enter into an agreement under the Economy Act, a formal contract under the FAR is not signed by either side. Although the Supreme Court has ruled that AAFES is sovereign immune to the same extent as the rest of the federal government, we often encounter contracting officers who demand that AAFES sign a FAR contract when using 2492 as authority to purchase from us. Many are reluctant to accept our position that the word "agreement" in the statute, combined with our sovereign immune status, obviates the need for a FAR contract.

We believe that it would be beneficial to include a provision in the DoD FAR Supplement (DFARS) concerning the availability and use of 2492 for purchases by qualified DoD agencies. We understand that contracting officers often take conservative approaches with regard to untried or new methods of procurement, particularly given the scrutiny they face. We believe that a DFARS provision concerning 2492 will provide a regulatory framework that will encourage contracting officers to use the statute as Congress intended.

The second law that applies to the military exchanges and provides contracting flexibility to DoD agencies is 10 United States Code 2424. This law allows any element of DoD to purchase supplies or services from a military exchange store outside the United States. Other than competitive procedures are specifically authorized and the contract may not exceed \$50,000.

We believe that 2424 was intended by Congress to give DoD elements overseas a statutory exception to the Competition in Contracting Act (CICA). Unfortunately, use of the word "contract" has created obstacles similar to those we have encountered in relation to 2492. We do not believe it should not be necessary for a sovereign immune federal instrumentality to sign a FAR contract that contains clauses that are legally inapplicable to the federal government. For example, there is no need for a CDA Disputes Clause because, based on Supreme Court precedent and Government Accountability Office (GAO) decisions, federal entities cannot sue each other. This is sometimes called the "interdepartmental waiver doctrine" and is based on the principle that the government cannot be both a plaintiff and a defendant in a lawsuit. GAO has

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also held that it is inappropriate for one federal entity to offset a debt against payments to another federal entity.

We believe that a possible solution to this issue would be to create a special contract form in the DFARS for purchases made under authority of 2424. It would contain only those clauses absolutely necessary for the purchase of goods and services and would not contain clauses that do not and should not apply to a federal government agency. If a contract like this was made available to DoD contracting officers, we believe that it would give DoD more flexibility to obtain goods and services under 2424.

There are a number of federal procurement laws that are not applicable to AAFES. These include the Small Business Act and CICA. There are obviously differences of opinion within the federal procurement community concerning the purposes and impacts of these statutes. Regardless, by making these laws inapplicable to the military exchanges, Congress has given a level of flexibility and discretion to NAFI contracting that does not exist in the appropriated fund procurement arena.

The military exchanges are not exempt from all procurement laws applicable to appropriated fund federal agencies. Laws that apply to NAFIs include the SCA, the Davis-Bacon Act, and the PPA. The Buy American Act applies to all procurements except purchases for resale.

Disputes arising under or relating to the contracts of military exchanges are governed by the CDA and the Tucker Act. Just like for appropriated fund agencies, contract disputes are litigated before the Armed Services Board of Contract Appeals or the U.S. Court of Federal Claims.

Another difference that gives NAFIs additional flexibility is lack of GAO jurisdiction over NAFI procurement protests. Within AAFES, protests are handled internally. The initial response is issued by the contracting officer and an appeal is permitted to the AAFES Commander.

While there may be a relative lack of statutory authority governing NAFI and AAFES procurement, there are regulations that provide many specific mandates and prohibitions. Military exchange procurement policy is specifically governed by DoD Directive 4105.67, Nonappropriated Fund (NAF) Procurement Policy, and DoD Instruction 4105.71, Nonappropriated Fund (NAF) Procurement Procedure.

According to these regulations, there are three basic principles concerning NAF procurement. These are that NAF procurement shall be done by trained procurement personnel; in a fair, equitable and impartial manner, and to the best advantage of the NAFI. Obviously it's much more complex than that, but AAFES procurement policy flows from these three basic concepts. These principles are very similar to the basic principles of the FAR.

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Similarities to the FAR do not end there. As stated in these DoD regulations, NAF procurements must use competitive solicitation procedures to the maximum extent practicable, with offers solicited from a reasonable number of sources unless non-competitive procurement is justified. Contracts shall be awarded to responsible offerors and to those who offer the best value to the NAFI. Awards may not be made to contractors on the GSA list of debarred, suspended or ineligible contractors. All NAF contracts must contain clauses concerning changes, audits, disputes resolutions and terminations. Alternative purchasing methods that do not necessarily require a formal written contract are authorized.

Specific procurement policy for each DoD NAFI is set by the "contracting authority" for the NAFI, as delegated to that person by regulation from DoD through the military services. For AAFES the contracting authority is the AAFES Commander, who has further delegated authority to set procurement policy to the Director of Purchasing. Within AAFES that position is held by either an Army or Air Force colonel who is generally a career procurement officer.

Although this delegation of authority may appear to give the AAFES Commander and his or her designee a great deal of flexibility and discretion, in fact DoD Instruction 4105.71 places a number of mandates and limits of AAFES procurement. Again, these mandates and limits mirror many of the basic principles in the FAR. The contracting authority is required to set standards for NAFI procurement; ensure individual responsibility for properly using NAF resources; establish training and certification requirements for contracting personnel; ensure inclusion of mandatory contract clauses in all contracts, and establish protest procedures. The contracting authority must also ensure that standards exist for contract documentation, protests and appeals, disputes, and contract administration.

At the same time, AAFES has taken advantage of the flexibility granted by regulation to implement practices that are more akin to industry than to government. One example is the standard contract termination clause. AAFES most often uses a mutual termination clause, which permits either party to terminate with a specified period of notice. While the risk is that a contractor may terminate unexpectedly, AAFES has determined that the mutual clause gives it greater flexibility to change direction based on business needs, while limiting the financial liability associated with the standard government termination for convenience clause. AAFES has implemented a modified termination for convenience clause for those situations where it is more advantageous to AAFES to ensure that the contractor does not terminate early. However, the contracting officer must justify use of the convenience clause in lieu of the mutual clause.

When purchasing internally-used supplies, services and equipment, AAFES policies and procedures are closer to the FAR procedures for these types of procurements. We believe that AAFES retail procurement is the closest equivalent to the purchase of commercial goods by federal government agencies. Another type of procurement, called a concessionaire contract, allows AAFES to provide direct customer services

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through a contractor, and is the closest equivalent to the purchase of commercial services by federal government agencies. For that reason, in my discussion of commercial practices I will focus on these two types of procurements. I will talk about retail procurement first.

Within AAFES, goods purchased for resale are procured using the AAFES Retail Agreement, or ARA. This agreement contains the mandatory clauses required by DoD regulations, other clauses determined necessary by the AAFES contracting authority, as well as provisions written specifically for the purchase of retail merchandise. The ARA is authorized as an alternative to a standard contract under DoD Instruction 4105.71.

The ARA is not a contract in and of itself. It is a set of terms agreed to by a supplier that will apply to each purchase made by AAFES from that supplier. Actual purchases are initiated using purchase orders that reference the terms of the ARA. A contract is formed when the order is filled. Orders can be cancelled by AAFES prior to completion, and a retail contractor is not required to fill orders placed by AAFES. AAFES has no obligation to purchase any set amount from any contractor and can adjust orders issued, and quantities within those orders, based on customer demand, seasonal stock assortment requirements, and other factors peculiar to the retail industry.

Selection of AAFES retail suppliers is generally based on factors other than competition. In many cases the items being purchased are brand name goods that are only available from a single source, either the manufacturer or an exclusive distributor for those goods. This puts emphasis on two other procurement factors – market research and setting the price AAFES will pay.

For retail merchandise, AAFES approaches market research a bit differently than in a traditional federal procurement setting. Retail contracting officers are assigned to categories, such as electronics, men's clothing, watches, and so forth. These contracting officers are expected to be highly knowledgeable about their categories and must keep up with the latest trends and releases. To obtain this information, AAFES sends retail contracting officers to industry trade shows and other meetings that would probably not be useful to most government contracting officers. AAFES also has a vendor area within the headquarters building that contains rooms set up to allow vendors to visit and display their merchandise.

Keeping up with industry and business trends is an important part of market research, both for individual contracting officers and AAFES senior management. AAFES retail contracting officers attend national and global trade shows to review offerings from all manufacturers within the respective market. The manufacturers' representatives keep AAFES apprised of emerging trends and other changes within the industry. In addition, retail contracting officers continue to keep abreast of the market through trade publications and other print media. To achieve other strategies with market research, AAFES conducts business with third parties to obtain data and

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information to measure and monitor internal market conditions. AAFES cooperates with and provides interviews and information to trade and industry publications, and maintains memberships in appropriate industry organizations, to keep the lines of communication between AAFES and industry both open and cooperative.

With regard to pricing retail goods purchased on a single source basis, the knowledge and experience of the retail contracting officer is critical to ensuring that AAFES gets the best possible price. Like most retailers, AAFES obtains information about retail prices at other department and discount stores. This information, along with knowledge of where and how goods are manufactured, enables retail contracting officers to determine a fair cost price. The ARA also contains a clause requiring retail contractors to give AAFES the best price for goods purchased in similar quantities to other purchasers. This clause is subject to audit by a third party audit contractor, so suppliers know that they will be checked periodically for compliance.

Generally AAFES retail suppliers sign the ARA without reservation. The clauses of most concern to these suppliers are the Equal Employment Opportunity (EEO) clause based on Executive Order (EO) 11246; the clause requiring contractors to indemnify and hold harmless AAFES for certain damages, and the clause allowing audit of the contractor's records.

Resolution of issues relating to the EEO clause is the most problematic. Generally, contractor objections are not based on a desire to avoid compliance with EEO requirements. Rather, the issue, according to AAFES suppliers who have raised this concern, is the cost of compliance and whether that cost is worth the potential business relationship with the government. Individual supplier's overhead and other operating costs are proprietary and AAFES has not been given specific figures. What we have been told is that the cost to put systems into place to maintain necessary documentation in the event of an EEO audit is considerable when compared to the potential revenues to be obtained from the business relationship with AAFES.

While one would think that most potential suppliers would want any business they could get, within the retail arena there are many large suppliers who have plenty of non-government business. Some of these suppliers manufacture highly desirable brand name merchandise, for which there is no shortage of demand in the private retail sector. In other words, there may not be sufficient motivation to convince some suppliers to accept the ARA with this clause.

Clearly the clause cannot be deleted, nor can the essential terms be altered. AAFES has in fact lost business because of this clause. When an accommodation was reached it was usually with a supplier who either had a separate government subsidiary or was willing to create one to limit the risk and cost. We recognize the purpose of requiring government contractors to comply with the EO and we would never suggest that it be eliminated from government contracting. We do suggest that it may further the efficiency of federal procurement if the reporting and compliance requirements could be simplified in a way that would cost suppliers less money.

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With regard to the audit and indemnity clauses, AAFES is required to have clauses on those topics but has authority to negotiate the language contained in the clauses. Through negotiation a solution can usually be reached that satisfies the supplier while preserving the government's rights.

Another issue that occasionally arises in the AAFES retail procurement area is what lawyers call the "battle of the forms." Some AAFES suppliers don't contract with other entities within the federal government, and others perceive AAFES as a corporation rather than part of the government. These types of suppliers are more likely to demand that AAFES sign their contract form, rather than signing the AAFES ARA. Some will even argue that the Uniform Commercial Code (UCC) will govern any conflicts, a position that AAFES rejects since the UCC is enacted through state statutes and AAFES is sovereign immune.

The solution in these cases rests with negotiation. Supplier clauses that are not inconsistent with the ARA can be incorporated into the ARA by reference. The language of any non-mandatory AAFES clause can be negotiated as long as the contracting officer has a reasonable basis for doing so. AAFES retail contracting officers routinely negotiate with suppliers on provisions peculiar to the retail industry, such as payment discounts, guaranteed margins relative to cost prices, FOB terms, and pre-ticketing. They also always consider all discounts, allowances and programs being offered by the supplier and negotiate the best terms relating to those things based on AAFES strategic objectives and customer needs. If a supplier refuses to remove conflicting clauses, it is sometimes possible to add a conflict clause giving the ARA precedence.

There are two other areas that impede AAFES' ability to conduct retail procurement as efficiently and effectively as commercial companies. One is the impact of the PPA on how discounts are handled. The other is the inability of a government entity to assess penalties against contractors.

As stated previously, the PPA applies to AAFES procurements. AAFES finds that, with regard to discounts, the PPA is inconsistent with standard and accepted industry practices. For example, the retail industry is evolving toward the practice of not paying for goods until they are actually sold. The PPA requires the government to count days for purposes of taking a discount based on the invoice date. For AAFES this means that often the invoice is received and paid before the goods are received. AAFES then carries the inventory costs, plus we must take any offsets for shortages or defective merchandise against the next invoice. AAFES and other government "retailers" would greatly benefit from changes to the PPA that would permit use of industry practices with regard to discounts.

Within the retail industry, it is important to get goods to stores on time. Merchandise cannot be sold if it's not on display. If it arrives too early, it must be stored in the stock room or warehouse at the expense of the retailer. Customers become frustrated if goods advertised for sale are not available, or are available but not in sufficient

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quantities to satisfy demand. It does a retailer no good to put Halloween candy on the shelves so early that it becomes stale, or too late for customers to conveniently purchase it. At the same time, if a noncompliant supplier is the only source for a particular item, it is not practical to stop doing business with that supplier.

Because of these considerations, most commercial retailers place penalty clauses in their supplier contracts to discourage early shipments, late shipment, and shortages. These penalties are sometimes extremely high for repeat offenses. Based on legal precedent holding that the government does not charge contractors with penalties, AAFES and other resale NAFIs cannot place industry-standard clauses in supplier contracts.

Examples of the differences between what is charged by AAFES and what is customary in industry for shipping violations can be seen on the slide. Generally AAFES charges \$50 per violation, and not more than \$100. This is liquidated damages that were calculated based on the average estimated costs to AAFES to obtain correction of the violation. In contrast, industry charges for violations start higher than the maximum AAFES charge. Where goods must be returned to the supplier, the percentage charged against the cost of goods can run into the thousands.

It is often difficult, if not impossible, to quantify either actual damages, or to estimate reasonable damages for purposes of a liquidated damages clause. Being able to place penalty clauses in these types of contracts would aid resale NAFIs in securing supplier compliance with shipping terms, thus reducing costs related to noncompliant suppliers.

The other type of AAFES contract with commercial procurement implications is the concession contract. These contracts are awarded to independent contractors, who provide direct customer services within AAFES facilities and pay a fee to AAFES. Last year, long term concessionaires generated \$1.3 billion in sales, resulting in \$1.7 million in income to AAFES. AAFES provides the space and may even provide the equipment, for an additional fee. The contractor is responsible to comply with all legal and regulatory requirements applicable to the business, to include collection and payment of sales taxes. AAFES generally expects prices at these concessions to be lower than what customers would pay to similar businesses in the private sector.

Many AAFES concession contracts are considered to be "core businesses" because of the AAFES customer base. For example, military members are required to keep their hair short and therefore probably get more haircuts than the civilian population. They need and want relatively inexpensive barber services in convenient locations to their workplace. Another example is laundry, dry cleaning and alternations, which are essential services for military members so they can keep their uniforms clean, tailored and within applicable regulations.

Installation commanders view having these core businesses on their installations as part of the quality of life for their servicemembers. Unlike a private retailer, AAFES is expected to provide these services worldwide, even if they are not profitable at some

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locations from a business standpoint. AAFES also tries to provide lower pricing than is available on the commercial market, while facing direct competition from similar off base businesses, many of which are just outside installation gates.

Overcoming these challenges is made extremely difficult because of the applicability of the SCA to these concessions. The difficulties associated with applicability of the SCA to these contracts illustrates the challenge the government faces when trying to apply commercial practices to government contracting. Although NAFI contracts are not mentioned in the SCA, the Department of Labor (DoL) has made the statute applicable to contracts that provide customer services on military installations. This means that AAFES concessionaires usually must pay their employees more per hour than businesses off the installation pay, and also must provide a level of benefits not provided to those businesses. This forces concessionaires to demand that AAFES allow them to charge higher prices, or requires AAFES to accept a lower fee in order to maintain core concession operations on the installation. Either the customer pays more, or goes elsewhere, thereby reducing revenues to AAFES and lowering the overall dividend that goes back to the customer.

In some remote locations AAFES has been unable to find contractors willing to take certain concession contracts, or has had to take a low or even zero fee to keep a contractor from terminating the contract. AAFES has had some success convincing the DoL to use more comparable wage rates when setting the rate applicable to these contracts, but this has been limited and has taken a great deal of time and effort. The ideal solution from AAFES' perspective would be for the DoL to give the military exchanges the same exception granted to National Parks Service concessionaires. According to the DoL regulation, the SCA is not applicable to Parks Service concessionaires because they face competition from businesses outside the national parks. The military resale community by and large faces the same sort of competition from off-installation retailers and other businesses.

The same concerns exist with regard to applicability of the Davis-Bacon Act and other similar laws. AAFES builds and renovates its own facilities with its own money, which come from nonappropriated earnings. Increased costs resulting from wages higher than those in the private sector make it more difficult for AAFES to achieve an industry-standard return on investment from construction or renovation projects. And every dollar of earnings spent on these projects is another dollar not available for the dividend. While not directly applicable to this Panel's topic of review, increased costs related to any federal procurement law is illustrative of the overall challenge faced by NAFIs such as AAFES.

Performance-based contracting is generally not consistent with retail procurement, which deals with the purchase of goods rather than services. AAFES does use some performance-based contracting for internal procurements. However, it has not been perceived as the procurement method most suited to AAFES' business practices.

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AAFES does use best value acquisition strategies on a regular basis. These are used both directly and indirectly in retail and customer services procurement.

Procurement of brand name retail goods does not lend itself to traditional government procurement best value acquisition. For one thing, best value acquisition strategies are usually competitive, while brand name retail procurements are not. However, the principle of "best value" is always a factor when purchasing merchandise for resale. If there is customer demand for the brand name, it is by definition a "best value" in the generic sense. If a supplier has proven to be more reliable in terms of shipping and quality of goods, there are times when a slightly higher cost price will be paid to that supplier. Additionally, there are some categories of retail merchandise that are procured using best value acquisition strategies that are similar to FAR processes.

One example of indirect best value procurement is a requirement for a category of items where there is no brand preference or leading market brand. In that case the retail contracting officer will conduct a solicitation. These solicitations often involve obtaining samples and, depending on the product, may include testing by AAFES quality assurance personnel. The decision on which items to purchase usually does not depend solely on the cost price. Quality, durability, packaging, and other consumer-related factors may be considered.

A second example of indirect best value procurement is procurement of private label merchandise. This is merchandise manufactured for AAFES or the military exchanges, such as film, over-the-counter drugs, clothing, and even diapers. Again a solicitation will be used, samples will be obtained, and quality assurance testing will be conducted. While price is clearly a major consideration, the lowest priced goods will not necessarily be procured if, in the judgment of the contracting officer, a higher priced line would be a better value for the customer.

AAFES utilizes formal and information best value source selection for some customer service concession contracts. These are generally in the health or medical category, such as contracts for optometry services, with a goal of providing the highest quality service for a reasonable price. AAFES has also experimented with best value procurement for internal services related to customer sales, such as for janitorial services to clean AAFES stores. Within the retail industry, cleanliness of stores, particularly restrooms, is a "hot button" issue for customers and a focus of customer satisfaction surveys.

These procurements are conducted with formal procedures that required a Source Selection Committee and a Source Selection Authority (SSA), or with informal procedures where proposals are evaluated by a technical evaluator and the contracting officer acts as the SSA. As with best value acquisitions under the FAR, the goal is a reasonable tradeoff between price and quality, as defined in the acquisition charter and the solicitation itself.

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With regard to responsibility, NAFIs are required by DoD regulation to award contracts only to responsible offerors. DoD Instruction 4105.71 defines responsibility as the determination that the offeror has adequate financial and technical resources, or the capability to get the resources, as well as a satisfactory record of performance demonstrating capacity to perform the contract. As is the case with all government procurement, responsibility determinations must be made by a contracting officer. As you can see, this is another area with NAFI contracting is similar to the standards in the FAR.

Within AAFES, different emphasis is placed on the various factors used to make a responsibility determination vary, depending on the type of contract being awarded. Contracts for services to be provided directly to AAFES emphasize management and key personnel. Contracts for equipment and supply are evaluated using typical responsibility factors such as past performance and financial capability.

In procurement of items for resale, a great deal of emphasis is placed on financial capability. Retail contracting officers are more likely to look at business information, such as reports available from Dun and Bradstreet, when evaluating a potential retail supplier for responsibility. Responsibility determinations are also more fluid in this category. By that I mean that a retail contracting officer can determine that a potential supplier is responsible, but only to a certain dollar limit. Purchases with that supplier can be limited to that dollar limit, since under the ARA, AAFES determines how many orders are issued and the value of those orders.

This system has advantages for both AAFES and suppliers. AAFES is able to establish long term relationships with suppliers and, if warranted, gradually increase contracting with reliable suppliers. This enables AAFES to control risk when dealing with a new or small supplier. From the supplier side, small businesses or new suppliers are able to demonstrate capability to AAFES, and have the potential to increase business without having to commit to a large contract up front. This is a win-win situation for both sides.

In the concession contract area, SCA applicability limits the maximum term of the average concession contract to five years. Because these concessions offer customer service, as a retailer AAFES wants to maintain the expected level of service even if the concession changes hands. One way to do this is to solicit only those offerors who have demonstrated the ability to run a business similar to the concession they are competing for.

To ensure that offerors for these solicitations are at least minimally qualified, AAFES sets responsibility standards in the solicitation itself. An offeror on a concession contract must be able to demonstrate that, in the 12 months before submitting an offer, it has had revenues equal to or greater than the estimated annual sales for the concession contract for the same or similar business. Offerors who cannot demonstrate this may not be placed on the source list. The contracting officer may waive this requirement for good cause. While this may seem to unduly restrict

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Ms. Marcia Madsen

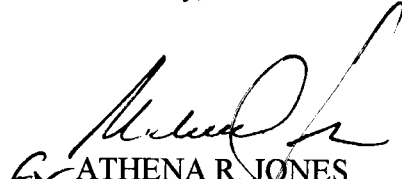
competition, AAFES keeps a current list of potential and qualified sources for concession contracts, and is always seeking new sources. Source lists for concession solicitations usually have at least two or more viable sources, and the need to waive the qualification standards is fairly rare.

In conclusion, AAFES procurement is both similar to, and very different than, contracting done under the FAR. At heart AAFES is an integral part of the military community and is a government entity. We believe that AAFES has a role to play in helping the federal government increase flexibility in procurement. More importantly, we think this role has been recognized by Congress, which has designated military resale activities as viable and available sources of goods and services for DoD agencies.

As flexible as AAFES procurement may appear to those who work within the appropriated fund system, I have highlighted a few of the legal challenges we face with regard to PPA discounts, the SCA, and the inability to use industry practices to motivate contractors to comply with shipping terms. We believe that solutions to these challenges would benefit the entire federal procurement community.

Thank you for the opportunity to talk to the Panel about these important issues.

Sincerely,


for ATHENA R. JONES
Colonel, USAF
General Counsel